

MICHAEL D. WHITTEN, CPA, CIA
GENERAL AUDITOR & DATA SECURITY OFFICER

MEMPHIS LIGHT, GAS AND WATER DIVISION

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T.R.A. DOCKET ROOM

January 20, 2004

Mr. David Foster
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RECEIVED

JAN 26 2004

TN REGULATORY AUTHORITY
TELECOMMUNICATIONS DIVISION

Dear Mr. Foster

Enclosed for your review and files is a signed copy of the engagement letter between MLGW and Warren, Averett, Kimbrough & Marino, P.C. for the 2002 Agreed Upon Procedures review of Memphis Networx, LLC. Also attached for your review is the list of procedures to be performed during the engagement.

Field work is in progress as of this morning, with a projected completion in early February. I will keep you informed as we get closer to a report date.

Sincerely,


Michael D. Whitten, CPA, CIA

General Auditor and Data Security Officer

WARREN, AVERETT, & KIMBROUGH & MARINO, LLC

Certified Public Accountants • Business & Financial Consultants

December 22, 2003

Attn: Mr. Mike Whitten
Memphis Light, Gas & Water Division
220 South Main Street
Memphis, Tennessee 38130-3917
and
Memphis Networkx, LLC
7620 Appling Center Drive, Suite 101
Memphis, Tennessee 38133

Dear Mr. Whitten,

Warren, Averett, Kimbrough & Marino, LLC and its affiliates (WAKM Companies, LLC) are pleased to provide Memphis Light, Gas & Water Division (MLGW or the "Company") and Memphis Networkx, LLC with professional services. This engagement letter embodies the entire agreement regarding the services to be rendered by our firm to you.

We will perform agreed-upon procedures as set forth in Attachment A, which were agreed to by the Tennessee Regulatory Authority (TRA) and management of MLGW and Memphis Networkx, solely to assist you in evaluating compliance with the TRA order dated August 9, 2001, as amended, during the period August 9, 2001 through December 31, 2002. We expect to begin field work on January 5, 2004 and present our findings by February 20, 2004.

Should conditions not now anticipated preclude us from completing our engagement and issuing an agreed-upon procedures report as contemplated by the preceding paragraph, we will advise you and representatives of the TRA promptly and take such action as we consider appropriate.

Our report will be restricted to MLGW, Memphis Networkx, and the TRA since only these parties have agreed upon the procedures to be performed and taken responsibility for the sufficiency of those procedures. In addition, our report will include all findings from the application of the agreed-upon procedures.

Responsibilities and Limitations

We will conduct our agreed-upon procedures engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures performed either for the purpose for which this report has been requested of for any other purpose.

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fax (256) 739-1896

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Birmingham, Alabama 35243-4226
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fax (205) 979-6313
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Post Office Box 559
Jasper, Alabama 35501
(205) 221-6109
fax (205) 384-9215

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Any modifications to the procedures expected to be performed will be communicated to the specified parties for their agreement.

We may also communicate other opportunities we observe for the economies in, or improved controls over, the Company's operations.

Specified Parties' Responsibilities and Representations

MLGW, Memphis Networkx, and the TRA have reviewed the attached procedures that are expected to be performed and have agreed to the sufficiency of those procedures for their purpose.

MLGW, Memphis Networkx, and the TRA are solely responsible for the sufficiency of the procedures performed.

Compliance with the requirements applicable to its activities is the responsibility of the management of the Company, which is also responsible for identification of applicable compliance requirements, for establishing and maintaining internal control to provide reasonable assurance of compliance with those requirements, and for evaluating and monitoring the Company's compliance. Management of the Company is also responsible for specifying reports that satisfy legal, regulatory, or contractual requirements.

Our fees for these services will generally be billed at our standard per diem rates together with any out-of-pocket costs. However, the fees for services may include a premium for service resulting from other factors deemed relevant, including, but not necessarily limited to, the difficulty of the issues and the time limitations imposed. We anticipate our fees to range from \$35,000 to \$45,000.

Memphis Light, Gas & Water Division (MLGW or the "Company") and Memphis Networkx, LLC, its officers and its directors, agree to release, defend, indemnify, and hold harmless this Firm, its successors, and assigns from any and all liability and costs resulting from knowing misrepresentations by management of Memphis Light, Gas & Water Division (MLGW or the "Company") and Memphis Networkx, LLC.

By signing this engagement letter, you agree to seek mediation for the resolution of claims against the Firm. If you recover less than is offered by this Firm or its representative in mediation, litigation or other settlement negotiations, you agree to reimburse this Firm for any legal fees incurred with the resolution of the dispute.

You also agree to pay an amount equal to other legal fees incurred by this Firm in connection with this engagement, including, by the way of illustration and not limitation, legal fees incurred through the advice on all issues relating to this engagement, legal fees incurred in connection with any suit to recover the fees due this Firm on this engagement, or legal fees incurred by this Firm in responding to any subpoenas or other legal process relating to this engagement.

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We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

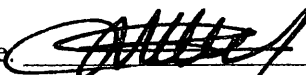
Very truly yours,



Joseph B. Anderson, CPA
Warren, Averett, Kimbrough & Marino, LLC

RESPONSE:

This letter correctly sets forth the understanding of Memphis Light, Gas & Water Division (MLGW or the "Company") and Memphis Networx, LLC

Officer signature: 

Title: Sr. V.P. CFO & Sec Treas

Date: 1-20-04

WORK PLAN
MLGW- MEMPHIS NETWORKX - TRA
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INTRODUCTION

On August 9, 2001, the Tennessee Regulatory Authority ("Authority" or "TRA") issued an order approving the Joint Petition of Memphis Light, Gas & Water Division ("MLGW") and Memphis Broadband, LLC for the creation of and operation of Memphis Networkx, LLC ("Memphis Networkx"). Further, the Authority granted the application of Memphis Networkx, LLC for a Certificate of Public Convenience and Necessity.

Based upon TRA order issued on August 9, 2001, appropriate professional standards and discussions with TRA, MLGW and Memphis Networkx representatives, it has been agreed that the following procedures will be performed and an Agreed-Upon Procedures Report ("AUP") will be issued.

Client Assistance List

The following information should be provided to the auditors at the beginning of on-site fieldwork. Copies should be provided for inclusion in workpapers unless otherwise noted. The period subject to the AUP is August 9, 2001, to December 31, 2002; therefore, information requested is for the year ended December 31, 2002 and for the period August 9, 2001, to December 31, 2001.

- I. Financial, organizational and contractual information:
 - A. Financial statements for:
 1. MLGW, inclusive of the Telecommunications Division;
 2. The Telecommunications Division of MLGW;
 3. Memphis Networkx.
 - B. Internal audit reports of MLGW for the period of August 2001 to December 31, 2002 that relate to the Telecommunications Division.
 - C. Audited financial statements for MLGW for 2001 and 2002 with report of independent auditors.
 - D. Audited financial statements for Memphis Networkx for 2001 and 2002 with report of independent auditors.
 - E. Chart of accounts and trial balance for the Telecommunications Division of MLGW;
 - F. Cost allocation manual pertaining to the Telecommunications Division.
 - G. Operating Agreement between MLGW, Memphis Broadband and Memphis Networkx.
 - H. All written contracts entered into between MLGW and Memphis Networkx; and a summary of any oral contracts or agreements between MLGW and Memphis Networkx.
 - I. All other written contracts and agreements, including loans, entered into between MLGW and its Telecommunications Division; and a summary of any oral contracts or agreements between MLGW and its Telecommunications Division.
 - J. Listing of contracts between MLGW and third-parties for pole attachment rates and underground installations. Have all contracts available.
 - K. Listing of employees of MLGW and Memphis Networkx.

WARREN, AVERETT, &
KIMBROUGH & MARINO, LLC

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- L. Copy of the annual report filed with the TRA by MLGW and Memphis Networkx for the period August 2001 through December 31, 2002.
- M. A calculation of the effective interest rate on each loan from MLGW to the Telecommunications Division.

COMPLIANCE REQUIREMENTS

Note: Compliance requirements are outlined in the following State laws and Authority orders:

- A. Tenn. Code Ann. §§ 7-52-401 through 7-52-407 and statutes referenced therein
- B. Tennessee Regulatory Authority's August 9, 2001, Order approving Memphis Networkx franchise.

Applicable NARUC guidelines and FCC rules are as follows:

- A. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
- B. Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and
- C. Federal Communication Commission cost allocation rules, 47 Code of Federal Regulations §§ 64.901 through 64.904.

Below is a listing of compliance requirements:

- I. MLGW and Memphis Networkx shall not have common employees
- II. MLGW shall charge to Memphis Networkx the highest rate for pole attachments and underground installations as it charges third parties under comparable agreements required by Tenn. Code Ann. §7-52-405.
- III. Funds loaned to the Telecommunications Division by MLGW shall be loaned at a rate of interest not less the highest rate earned by the MLGW on invested electric plant funds.
- IV. MLGW shall not provide subsidies to Memphis Networkx as required by Tenn. Code Ann. §7-52-402.
- V. MLGW shall maintain records to comply with:
 - A. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
 - B. Federal Communication affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and
 - C. Federal Communication Commission cost allocation rules, 47 Code of Federal Regulations §§ 64.901 through 67.904.

WORK PLAN
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ENGAGEMENT PLAN

I. Engagement period

The period subject to this work plan is August 2001 through December 31, 2002.

II. Conditions of Engagement

A. The independent auditor selected is :

Joesph B. Anderson
Warren, Averett, Kimbrough & Marino
2500 Acton Road
Birmingham, AL 35243
Phone: (205) 979-4100
Fax: (205) 979-6313
Email: Anderson@wakm.com

B. Members of the audit team shall have sufficient understanding of the following:

1. Tennessee Code Ann. §§ 7-52-401 through 7-52-407 and statutes referenced therein;
2. Tennessee Regulatory Authority's August 9, 2001 Order approving Memphis Networkx franchise;
3. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
4. Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and
5. MLGW's cost allocation manual; and
6. Operating Agreement between MLGW, Memphis Broadband and Memphis Networkx.

C. Independent auditors shall be independent as defined in the Statements on Standards for Attestation Engagements as set forth by the AICPA and in compliance with the GAO independence standards.

D. In addition, to the extent the independent auditor determines procedures included in this plan cannot be performed, the independent auditor will notify the Authority if the independent auditor determines it is necessary to modify the agreed upon procedures.

**WARREN, AVERETT, &
KIMBROUGH & MARINO, LLC**

WORK PLAN
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- E. The independent auditor may use the services of a specialist for assistance in highly technical areas. The independent auditor and the specified parties shall explicitly agree to the involvement of any specialist to assist in the performance of the engagement. The specialist shall not be affiliated in any form with MLGW or Memphis Networkx.
- F. The independent auditor's use of internal auditors shall be limited to the provision of general assistance and the preparation of schedules and gathering of data for use in the engagement.

III. Representation Letters

- A. Obtained representation letters from MLGW and Memphis Networkx addressing the following compliance items:
1. acknowledgment of management responsibility for complying with specified requirements;
 2. acknowledgment of management responsibility for establishing and maintaining
 3. statement that management has performed an internal evaluation of its compliance with the specified requirements;
 4. statement that management has disclosed or will disclose to the auditor all known noncompliance occurring up to the date of the report;
 5. statement that management has made available all documentation related to compliance with the specified requirements;
 6. statement that management has disclosed all written communications from regulatory agencies from competitors, concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in management's assertion on the date of the auditor's report;
 7. statements that Memphis Networkx operates independently of MLGW; that MLGW owns no facilities jointly with Memphis Networkx; MLGW provides no operations, installation, and maintenance functions over the facilities owned by Memphis Networkx, or leased by Memphis Networkx from unaffiliated entities; Memphis Networkx provides no operations, installation, and maintenance functions over MLGW's facilities;
 8. statement that Memphis Networkx has separate officers, directors, and employees from those of MLGW;
 9. statement that MLGW charged to Memphis Networkx the highest rate for pole attachments and underground installations as it charges third parties under comparable agreements required by Tenn. Code Ann. §7-52-405.

WORK PLAN
MLGW- MEMPHIS NETWORKX - TRA
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10. statement that funds located to the Telecommunications Division by MLGW were loaned at a rate of interest not less than earned by the MLGW on invested electric plant funds.
 11. statement that MLGW did not provide subsidies to Memphis Networkx as required by Tenn. Code Ann. §7-52-402.
 12. statement that MLGW maintained records comply with National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry"; Federal Communication Commission affiliate transaction rules; 47 Code of Federal Regulations § 32.27; and Federal Communications Commission cost allocation rules, 47 Code of Federal Regulations §§64.901 through 64.904.
- B. Obtain representation letters related to financial issues signed by the Chief Financial Officer or the equivalent of MLGW and Memphis Networkx that include the following:
1. statement that Memphis Networkx maintains separate books, records, and accounts from those of MLGW and that such separate books, records, and accounts are maintained in accordance with Generally Accepted Accounting Principles ("GAAP");
 2. statement that Memphis Networkx has not obtained credit under any arrangement that would permit creditor, upon default, to have resource to the assets of the MLGW;
 3. statement that management has identified to the auditor all assets transferred or sold since the last audit, and services rendered: (i) by MLGW to Memphis Networkx, and (ii) by Memphis Networkx to MLGW, and that these transactions have been accounted for in the required manner;
 4. statement that management has not changed any of MLGW's processes or procedures (as they relate to transactions with Memphis Networkx) and that these procedures (as they relate to transactions with Memphis Networkx) and that these procedures and processes have continued to be implemented on a consistent basis, since the execution of these agreed-upon procedures without apprising the auditor, before the date of the report (on MLGW's representation letter only);
 5. statement summarizing events subsequent to the engagement period, but prior to the issuance of the report, that may affect compliance with any of the objectives described in this document.

WORK PLAN
MLGW- MEMPHIS NETWORKX - TRA
AUGUST 2001-DECEMBER 2002

IV. Engagement Process

- A. The work plan will be presented to the TRA representatives for review, The representatives will meet to discuss the overall plan and will agree upon the procedures to be performed.

V. Report Structure

The auditor shall present the results of performing the procedures in the form of an agreed upon procedures report consistent with AICPA standards.

WORK PLAN
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AUGUST 2001-DECEMBER 2002

OBJECTIVE AND PROCEDURES

OBJECTIVE: I. Pursuant to Tenn. Code Ann. § 7-52-405, determine whether MLGW has charged an amount for pole attachments and underground installations to Memphis Networkx equal to the highest rate charged by MLGW to any other person or entity for comparable attachments.

PROCEDURES

1. Obtain a listing of all pole attachment and underground installations agreements/contracts (including the billing rates) that MLGW has in place with other persons or entities. Select a sample of 5 contracts and agree the terms of the contract (rate charged for pole attachments underground installations, and conduit rental, term, customer) to the summary listing. The sample is to be chosen on a random basis.
2. Based on the listing of pole attachments and underground installations agreements provided by MLGW, determine the highest rate for pole attachments and underground installations. Select all contracts with Memphis Networkx for pole attachments and underground installations and compare the rates charged to the highest rate for pole attachments and underground installations that MLGW charges comparable persons or entities. The sample is to be chosen on a random basis.
3. Obtain a copy of the annual report filed with the TRA by MLGW and Memphis Networkx for the period August 2001 through December 2002. Agree the amount charged to Memphis Networkx by MLGW to the MLGW general ledger and to the amount stated in the annual report filed with TRA.

WORK PLAN
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OBJECTIVE II. Pursuant to Tenn. Code Ann. § 7-52-403, determine whether the interest cost for funds lent to the Telecommunications Division by MLGW to acquire, construct, and provide working capital for the system, plan and equipment are allocated at a rate not less than the highest rate earned by MLGW on invested electric plant funds.

PROCEDURES

1. Obtain copies of all loan agreements between MLGW and the Telecommunications Division between August 2001 and December 2002.
2. Compare the loan, interest expense/income and accrued interest amounts recorded in the Electric Division general ledger to the Telecommunications Division general ledger.
3. Obtain a calculation of the effective interest rate on each loan made by MLGW to the Telecommunications Division.
4. Obtain from MLGW a calculation of the rate MLGW earned on invested electric division plant funds during the loan period.
5. Compare rates of interest for loans to the Telecommunications Division with rates earned by MLGW on its invested electric division plant funds.
6. Compare rates of interest for loans to the Telecommunications Division with rates earned by MLGW on its invested electric division plans funds.

WORK PLAN
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OBJECTIVE III. Determine whether MLGW and Memphis Networkx have separate employees.

PROCEDURES

1. Obtain payroll ledgers, inclusive of employee names and social security/employee identification number, for MLGW and Memphis Networkx for the period August 2001 through December 2002.
2. Obtain a listing of all Networkx employees to test for inclusion on MLGW's payroll ledger. Cross reference employee names and social security numbers to test whether separate employees have been maintained.
3. Obtain from management a listing of anyone simultaneously employed by MLGW and Memphis Networkx.

WORK PLAN
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OBJECTIVE IV. Determine whether costs of MLGW have been properly allocated to its Telecommunications Division.

PROCEDURES

1. Obtain a copy of the annual report filed with the TRA by MLGW for the period August 2001 through December 2002.
2. Obtain a list of MLGW costs allocated to the Telecommunications Division and agree allocated amounts to the general ledger for the Telecommunications Division (allocated cost could include administrative and general, labor, travel, consulting, and/or other).
3. For each identified allocated cost, compare the amount of costs allocated to the Telecommunications Division with the amount stated in the annual report filed with the TRA.
4. For each identified allocated cost, obtain from MLGW the calculations used in determining the amount of costs allocated to the Telecommunications Division. Recompute the calculations used by MLGW to allocate the costs to the Telecommunications Division.
5. For each allocated cost, determine whether the calculation for allocating costs is in accordance with MLGW's cost allocation manual.
6. Agree amounts used in the cost allocation to MLGW's general ledger or other documentation from the accounting records of MLGW.

WORK PLAN
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OBJECTIVE V. Determine whether any other expenses of MLGW have been charged to its Telecommunications Division and if so, determine whether such charges are in compliance with the cost allocation manual.

PROCEDURES

1. Obtain a listing of expenses charged directly to the Telecommunications Division general ledger.
2. Randomly select 3 months of charges and agree each charge to the vendor invoice or other documentation of the charge.

WORK PLAN
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OBJECTIVE VI. Determine whether MLGW has billed Memphis Networkx the appropriate tariff for electric, gas and water services provided to Memphis Networkx.

PROCEDURES

1. Obtain copies of monthly bills rendered to Memphis Networkx by MLGW for electric, gas and water services from August 2001 through December 2002.
2. Obtain from MLGW the MLGW tariff rate schedule(s) applicable to Memphis Networkx for electric, gas and water service. Recalculate the invoiced amounts.
3. Agree monthly amounts billed from MLGW for electric, gas and water service to the general ledger accounts of Memphis Networkx.

WORK PLAN
MLGW- MEMPHIS NETWORKX - TRA
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OBJECTIVE VII: Determine whether the amounts billed by MLGW to Memphis Networkx for non-tariffed services, specifically make ready work and engineering, are appropriate.

PROCEDURES

1. Obtain from MLGW a summary of all non-tariffed services, specifically the type of work associated with the make-ready work and engineering, performed for Memphis Networkx by MLGW.
2. Obtain from MLGW all invoices/contracts, including underlying calculations, for all non-tariffed services billed by MLGW to Memphis Networkx from August 2001 through December 2002.
3. Agree amounts for all non-tariffed services per the general ledger to the amounts stated in the annual report by MLGW with the TRA.
4. For a sample of all charges for non-tariffed services, perform the following:
 - a. Agree the invoiced amounts to calculations/workpapers prepared by MLGW which were prepared by MLGW to support the invoice.
 - b. Recalculate the amounts provided by MLGW.

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OBJECTIVE VIII. Determine whether any revenues of MLGW have been allocated to its Telecommunications Division and, if so, determine the reasonableness of the allocation.

PROCEDURES

1. Obtain from MLGW the approach and rationale used in determining the method for allocating revenues to the Telecommunications Division.
2. Agree the approach used for allocating these revenues to the approach set forth in MLGW's cost allocation manual.
3. Obtain the detailed calculations used in determining the amounts of these revenues allocated to the Telecommunication Division. Test the clerical accuracy of the calculations.

WORK PLAN
MLGW- MEMPHIS NETWORKX - TRA
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PROCEDURES FOR SUBSEQUENT EVENTS

1. Inquire of management whether processes and procedures in place during the engagement period for ensuring compliance with statutory and Authority requirements have changed subsequent to the engagement period.
2. Obtain written representation from management as to whether any events have occurred subsequent to the engagement period, but prior to the issuance of the report, which may affect compliance with any of the objectives described herein.